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President Trump Says Mexico Will Pay for the Wall. But His Tax Plan Means Americans Will

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Donald Trump's peso politics may end up poisoning American pocketbooks.

On Thursday, President Trump floated a possible plan to pay for a wall between Mexico and the U.S.—a 20% tax imposed on importers of the stuff that is made in Mexico and shipped to the United States. And there is a lot of that stuff: About $295 billion worth of goods last year alone.

Trump said the plan, which was detailed by Trump's press secretary Sean Spicer before he later backed away from the proposal saying it was one of a number on the table, would force Mexicans to pay for building That Wall. And it sounds like it would, if you don't know anything about economics or trade relations between Mexico and the U.S., or really trade relations at all. The people who will ultimately pay aren't Mexicans, but U.S. customers who're currently getting a great deal on their products.

Unfortunately, the plan amounts to what's practically a textbook case in damaging, unintended consequences for the U.S. economy and consumers. The main point is that when a nation imposes a tariff on another nation's goods, it's a tax that, according to classical economics, generally raises the prices, and lowers the volume of sales, of those imports.

As we'll see, that's not a good thing for the U.S. or its consumers. Let's count the ways (and Mr. President, maybe you can count along with us).

Mexican companies would only write the checks. All import duties on cars, plastics, electronic components, and everything else we import from Mexico would at least in part be simply tacked onto the price of either the final products, or the components sold for final production in the U.S. So it's *our* shoppers who would mainly pay for those markups. Mexican companies are simply intermediaries who would collect money from U.S. consumers, and send the funds to the Treasury. "To pretend that Mexican companies would really pay is a distortion," says J. Bradford Jensen, an economics professor at Georgetown University. "U.S. consumers who would pay a lot of those costs."

50% of the content of imports from Mexico are components and other materials made in the U.S. The tariff would force Mexican companies to raise prices, though probably far less than the full 20%, since they'd take part of the hit by shrinking margins. That would make their goods less attractive to U.S. consumers, and they'd sell a lot less autos and appliances in the U.S. than they do today. At the same time, that would lower any revenue generated by the border tax to pay for the wall.

But U.S. manufacturers would take a hit as well, since if Mexican imports fall, so do all the U.S. parts that go into those imports. Those lost sales could go to either foreign companies or U.S. players that manufacture the same goods in the U.S., using U.S.-made parts. But if Mexico is the world's low-cost producer, the system deprives U.S. consumers of those bargain prices. We'd be buying the same stuff from less efficient domestic producers at what could be inflated prices.

If Mexico sells less to us, we sell less to them. As the flow of goods from Mexico to the U.S. shrinks, Mexican consumers will collect fewer dollars. Hence, by pure math, they'll have less to spend on U.S. exports. "It works against the administration's goal of increasing U.S. exports to eliminate our trade deficit," says Dan Ikensen, an economist at the Cato Institute.

The tariffs would create a new, protective umbrella for high-cost producers that would hit Americans in the wallet.

The plan would be a protectionist boon to inefficient manufacturers. The tariffs would enable U.S. or foreign companies that do everything in the US to grab market share from the Mexicans even if their costs are higher. Or, those sales would go to Canadian or Asian importers that can sell them more cheaply than U.S. competitors. Still not a good deal for consumers, since the foreigner would still charge more than the Mexicans did prior to the new wall—the tariff wall.

Mexico might retaliate. Mexico could fight back by imposing tariffs on U.S. exports. In that case, both our imports and our exports would decline in tandem. The Trump goal of lowering trade deficits by raising exports would be lost.

There is actually one scenario where Trump's tax might result in Mexico, or at least companies that are making goods in Mexico and exporting them to the U.S., paying for at least a portion of the wall.

In theory, if the U.S. were to impose a heavy tariff on another country, like say 20%, it could cause the value of dollar to rise. Americans would buy fewer goods from that country. The supply of dollars outside the U.S. would shrink. And the price of dollars would go up. Classic economic supply and demand theory. So if the value of the dollar rose, Mexican companies could raise their prices in pesos to pay for the tariff, and those higher prices wouldn't be felt by American consumers because higher value dollars would compensate for the difference.

But liberal leaning economist Dean Baker of the Center for Economic and Policy Research says for that to work you would have to impose tariffs on all countries, not just Mexico, because that's the way you can truly limit the supply of dollars outside the United States. But that still might mean that Mexico isn't the one that ends up paying for the wall. The reason: The U.S. imports roughly $500 billion of goods from China, nearly double the amount we get from Mexico. So if you were to impose a tariff on all good imported overseas to drive up the value of the dollar, it would be the Chinese that would end up paying the biggest portion of the bill building the wall between U.S. and Mexico, and not the Mexicans.

And that might not matter to Trump, or American tax payers, but it will certainly matter to the Chinese, who have warned against a trade war and will have all types of unintended consequences (at least by Trump) to impose on U.S. consumers.

"Ttump's plan gets Americans to pay for the wall through another channel, or China," says Baker. "This is not a plan to get Mexico to pay for the wall."

Bottom line: The open border between Mexico and the US has been a huge boon to both economies. A thriving Mexico is great for US exports, and though we're running a big trade deficit, the dollars Mexico collects flow back here in job-creating investments. This is a good deal for both sides. Let's not fix what's not broken.